

ORIGINAL



MEMORANDUM

30

TO: Docket Control

FROM: Ernest G. Johnson
EGJ
Director
Utilities Division

DATE: March 12, 2006

RE: STAFF REPORT FOR THE ARIZONA WATER COMPANY APPLICATION
FOR AUTHORIZATION FOR FINANCING DOCKET NO. W-01445A-05-
0886

Attached is the Staff Report for Arizona Water Company's application for authorization for financing. Staff recommends approval.

EGJ:DTZ:red

Originator: Daniel Zivan

Attachment: Original and fourteen copies

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DOCUMENT CONTROL

Service List for: Arizona Water Company
Docket No. W-01445A-05-0886

Mr. Robert W. Geake
Arizona Water Company
Post Office Box 29006
Phoenix, Arizona 85038-9006

Mr. Christopher C. Kempley
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mr. Ernest G. Johnson
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Lyn Farmer
Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**ARIZONA WATER COMPANY
DOCKET NO. W-01445A-05-0886**

**APPLICATION FOR AUTHORIZATION
FOR FINANCING**

FEBRUARY 2006

STAFF ACKNOWLEDGMENT

The Staff Report for Arizona Water Company, Docket No. W-01445A-05-0886 is the responsibility of the following Staff members: Daniel Zivan, financial analysis; Del Smith, engineering and technical analysis; and Kim Battista, compliance with Commission policies and rules; and Alfonso Amezcua, Consumer Services Analyst.



DANIEL ZIVAN
PUBLIC UTILITIES ANALYST III



DEL SMITH
UTILITIES ENGINEER



KIM BATTISTA
CHIEF OF COMPLIANCE AND ADMINISTRATION



ALFONSO AMEZCUA
CONSUMER SERVICES ANALYST

**EXECUTIVE SUMMARY
ARIZONA WATER COMPANY
DOCKET NO. W-01445A-05-0886**

Arizona Water Company ("Arizona Water" or "Company") filed an application requesting authorization for financing with the Arizona Corporation Commission ("Commission") on December 12, 2005. Arizona Water is a Class "A" Arizona for-profit corporation that serves approximately 73,000 customers in Cochise, Coconino, Gila, Maricopa, Navajo, Pima, Pinal and Yavapai Counties in Arizona.

Arizona Water proposes to issue long-term debt not to exceed \$25,000,000 through the sale of general mortgage bonds. The Company intends to apply the proceeds of the proposed financing towards the repayment of short-term debt in the amount of \$5,100,000 (as of September 30, 2005) and the retirement of its existing Series I bonds in the amount of \$400,000. Arizona Water anticipates that the short-term debt amount to be paid off with the proposed loan proceeds will be in excess of \$10,000,000 on December 31, 2005. Additionally, Arizona Water intends to use the proposed financing to acquire and improve plant and facilities.

Arizona Water's existing capital structure consists of 5.4 percent short-term debt, 22.7 percent long-term debt and 71.9 percent equity. Arizona Water's pro forma capital structure reflecting issuance of the proposed debt is 0.3 percent short-term debt, 40.1 percent long-term debt and 59.6 percent equity.

The pro forma times interest earned ratio ("TIER") and debt service coverage ratio ("DSC") resulting from the proposed \$25,000,000 long-term debt are 2.90 and 3.99, respectively. These ratios indicate that Arizona Water would have sufficient cash flow to service all present obligations and proposed long-term debt.

Staff concludes that the issuance of the proposed debt financing for the purposes stated in the application is lawful and within Arizona Water's corporate powers, compatible with the public interest, consistent with sound financial practice and will not impair its ability to provide services.

Staff recommends approval of the \$25,000,000 request for the authorization to incur long-term debt.

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SCHEDULES

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ATTACHEMENT

ENGINEERING REPORT

PUBLIC NOTICE

Introduction

Arizona Water Company ("Arizona Water" or "Company"), an Arizona "C" corporation located in Phoenix, Arizona, filed an application requesting authorization for financing with the Arizona Corporation Commission ("Commission") on December 12, 2005.

Notice

Notice of a financing application was published in *The Arizona Republic* on January 10, 2006 and in *The Arizona Daily Star* on January 10, 2006. The affidavits of publication are attached along with a copy of the Notice.

Background

Arizona Water is a Class "A" Arizona for-profit corporation located in Phoenix, Arizona. Arizona Water provides service to approximately 73,000 customers located in Cochise, Coconino, Gila, Maricopa, Navajo, Pima, Pinal and Yavapai Counties in Arizona.

Purpose of the Financing

Arizona Water proposes to issue debt, in the form of general mortgage bonds, in an amount not to exceed \$25,000,000. Arizona Water intends to apply the proceeds of the proposed long-term debt towards the repayment of short-term debt in the amount of \$5,100,000 (as of September 30, 2005) and the retirement of its existing Series I bonds in the amount of \$400,000. Arizona Water anticipates that the short-term debt amount to be paid off with the proposed loan proceeds will be in excess of \$10,000,000 on December 31, 2005. Additionally, Arizona Water intends to use the proposed financing to acquire and improve plant and facilities.

Description of Proposed Financing

Arizona Water proposes to issue and sell general mortgage bonds in an amount not to exceed \$25,000,000. Arizona Water expects that the bonds would have a maturity of 25 to 30 years and have an applicable interest rate equal to the 30 year Treasury Rate plus 200 basis points. The proposed bonds will be "secured by the lien of Applicant's Indenture to National Boulevard Bank of Chicago and Marshall A. Warshauer, as Trustees, dated April 1, 1963, as supplemented and amended."¹

Financial Analysis

Schedule DTZ-1 presents actual financial information for the year ended September 30, 2005, in column A. Column B presents pro forma financial information that reflects issuance of

¹ Page 2, Line 8 of Arizona Water's application

the entire \$25,000,000 proposed debt, amortized over 25 years with interest calculated at 7.50 percent per annum.

The times interest earned ratio ("TIER") and debt service coverage ratio ("DSC") for the year ended September 30, 2005, are 5.59 and 6.95, respectively (Schedule DTZ-1, column A). Issuance of the proposed debt would reduce the TIER and DSC to 2.90 and 3.99, respectively (Schedule DTZ-1, column B). A DSC of 3.99 demonstrates that Arizona Water would be able to meet all current obligations as well as the obligations associated with the proposed long-term debt in the amount of \$25,000,000.

TIER represents the number of times earnings cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not mean that debt obligations cannot be met in the short term.

DSC represents the number of times internally generated cash will cover required principal and interest payments on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

Schedule DTZ-1 shows Arizona Water's existing and pro forma capital structure including the issuance of the proposed debt. Arizona Water's existing capital structure consists of 5.4 percent short-term debt, 22.7 percent long-term debt and 71.9 percent equity. Arizona Water's pro forma capital structure reflecting the issuance of the proposed debt is 0.3 percent short-term debt, 40.1 percent long-term debt and 59.6 percent equity.

Compliance and Consumer Services

Arizona Water did not have any outstanding compliance issues as of January 30, 2006.

The Commission's Consumer Services Section received eighteen complaints, nineteen inquiries and nine opinions pertaining to Arizona Water in 2005. All complaints and inquiries have been resolved and closed.

Engineering Analysis

The Staff Engineering Report is attached. Staff reviewed the material cost estimates of Arizona Water's construction budget for 2006. Staff concludes that Arizona Water's cost estimates in the construction budget appear reasonable. Staff makes no "used and useful" determination in this proceeding. Treatment of the proposed plant improvements for rate-making purposes is deferred to a future rate proceeding.

Conclusion and Recommendations

Staff concludes that the proposed use of funds is appropriate and that authorization to incur an amount not exceeding \$25,000,000 of long-term debt for those purposes is lawful and within the corporate powers of the applicant, is compatible with the public interest, consistent with sound financial practices and would not impair Arizona Water's ability to provide service.

Staff recommends granting authorization to borrow an amount not to exceed \$25,000,000 under the terms and conditions proposed and for the purposes described in this application.

Staff further recommends approval of granting liens in favor of the lender as required to secure the borrowings authorized.

Staff further recommends authorizing Arizona Water to engage in any transactions and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that one copy of executed loan documents be filed with the Docket Control, as a compliance item in this matter, within 90 days of the decision in this matter.

FINANCIAL ANALYSIS

Selected Financial Data Including Immediate Effects of the Proposed Debt

| | | [A] | | [B] | |
|----|------------------------|--------------------------------------|-----------|------------------------------------|-----------|
| | | Twelve months ending 9/30/2005 | | Pro forma with recommended debt | |
| 1 | Operating Income | \$ | 6,899,524 | \$ | 6,899,524 |
| 2 | Depreciation & Amort. | | 5,249,006 | | 5,249,006 |
| 3 | Income Tax Expense | | 3,282,332 | | 3,282,332 |
| 4 | | | | | |
| 5 | Interest Expense | | 1,821,633 | | 3,513,840 |
| 6 | Repayment of Principal | | 400,000 | | 353,977 |
| 7 | | | | | |
| 8 | | | | | |
| 9 | TIER | | | | |
| 10 | [1+3] ÷ [5] | | 5.59 | | 2.90 |
| 11 | DSC | | | | |
| 12 | [1+2+3] ÷ [5+6] | | 6.95 | | 3.99 |
| 13 | | | | | |
| 14 | | | | | |
| 15 | | | | | |
| 16 | | | | | |
| 17 | | | | | |
| 18 | Short-term Debt | \$5,100,000 | 5.4% | \$353,977 | 0.3% |
| 19 | | | | | |
| 20 | Long-term Debt | \$21,400,000 | 22.7% | \$45,646,023 | 40.1% |
| 21 | | | | | |
| 22 | Common Equity | \$67,939,243 | 71.9% | \$67,939,243 | 59.6% |
| 23 | | | | | |
| 24 | Total Capital | \$94,439,243 | 100.0% | \$113,939,243 | 100.0% |
| 25 | | | | | |
| 26 | | | | | |
| 27 | | | | | |


[A] September 30, 2005 actual financial information

[B] Column [A] adjusted to reflect issuance of \$25,000,000 of long-term debt

MEMORANDUM

DATE: February 17, 2006

TO: Dan Zivan
Public Utilities Analyst III

FROM: Del Smith 
Engineering Supervisor

RE: Arizona Water Company
Application To Sell Additional General Mortgage Bonds
Docket No. W-01445A-05-0886

Introduction

Arizona Water Company ("Arizona Water" or the "Company") has filed an application with the Arizona Corporation Commission ("ACC") for an order authorizing the issuance and sale of \$25,000,000 of additional general mortgage bonds. The proceeds from the sale of these bonds will be primarily utilized by the Company to pay off outstanding Series I bonds and short term loans.¹ Arizona Water has informed Staff that some of the proceeds may also be used to construct improvements and additions to the Company's utility plant located in the State of Arizona.²

Construction Projects and Budgets

Arizona Water provided Staff with a copy of its construction budget for the year 2006. The construction projects and the associated cost estimates provided in this document appeared to be reasonable and appropriate. However, approval of this application does not imply any particular future treatment for rate base. No "used and useful" determination of the proposed plant in service was made, and no conclusions should be inferred for rate making or rate base purposes.

Water Quality Compliance

The Arizona Department of Environmental Quality ("ADEQ") and the Maricopa County Environmental Services Department ("MCESD") regulate the water systems operated by Arizona Water. ADEQ and MCESD have determined that these water systems are delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.³

¹ See Application at Page 3, Paragraph VI.

² Per email from Ralph Kennedy to Staff dated January 26, 2006.

³ Status reports from 2005 were used to determine compliance for some systems.

ACC Compliance Status

A check of the compliance database indicated that there were no delinquencies for Arizona Water.⁴

Curtailment Tariff

The Company currently has a curtailment tariff on file which covers all of its systems.

⁴ Per compliance check dated January 30, 2006.

EXHIBIT "A"

THE ARIZONA REPUBLIC

PUBLIC NOTICE OF AN APPLICATION FOR AN ORDER AUTHORIZING ARIZONA WATER COMPANY TO SELL BONDS

Arizona Water Company ("Applicant") has filed an Application with the Arizona Corporation Commission (the "Commission") for an order authorizing Applicant to issue and sell one or more additional series of its General Mortgage Bonds in an aggregate principal amount not to exceed \$25,000,000. The Applicant also seeks authorization to determine the precise amount and timing of the issuance and sale of each additional series of General Mortgage Bonds. The Applicant expects to issue the first series of bonds on or before July 31, 2006 at a negotiated rate of no more than 200 basis points over the 30-year Treasury Rate. The Application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, and at Applicant's offices throughout Arizona.

Intervention shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene must file a written Motion to Intervene with the Commission which must be served upon Applicant and which, at a minimum, shall contain the following information:

1. The name, address, and telephone of the proposed intervenor; and of any person upon whom service of documents is to be made if different than the intervenor.
2. A short statement of the proposed intervenor's interest in the proceeding (e.g., a customer of Applicant, a stockholder of Applicant, etc.)
3. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.

The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105, except that all Motions to Intervene must be filed on, or before, the 15th day after publication of this notice.

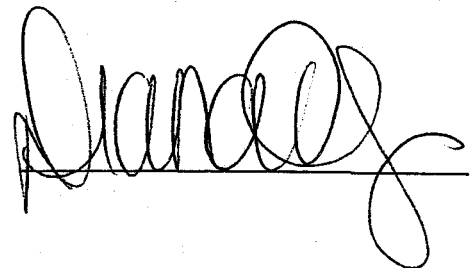
06013-January 10, 2006

STATE OF ARIZONA }
COUNTY OF MARICOPA } SS.

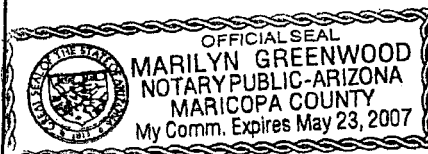
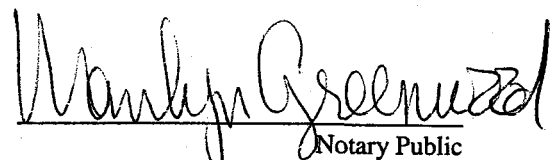
Diana Chavez, being first duly sworn, upon oath deposes and says: That she is a legal advertising representative of the Arizona Business Gazette, a newspaper of general circulation in the county of Maricopa, State of Arizona, published at Phoenix, Arizona, by Phoenix Newspapers Inc., which also publishes The Arizona Republic, and that the copy hereto attached is a true copy of the advertisement published in the said paper on the dates as indicated.

The Arizona Republic

January 10, 2006



Sworn to before me this
10TH day of
January A.D. 2006

Notary Public

EXHIBIT "A"

STAR PUBLISHING COMPANY

Tucson, Arizona

STATE OF ARIZONA)
COUNTY OF PIMA)

Cezar Duron, being first duly sworn deposes and says: that he is the Legal Advertising Representative of the **STAR PUBLISHING COMPANY**, a corporation organized and existing under the laws of the State of Arizona, and that the said **STAR PUBLISHING COMPANY** prints and publishes The Arizona Daily Star, a daily newspaper printed and published in the City of Tucson, Pima County, State of Arizona, and having a general circulation in said City, County, State and elsewhere, and that the attached

Legal Notice

was printed and published correctly in the entire issue of the said The Arizona Daily Star on each of the following dates, to-wit:

January 10, 2006.

[Signature]

Subscribed and sworn to before me this 2 day of
February, 2006

[Signature]
Notary Public



SILVIA H VALDEZ
Notary Public - Arizona
Pima County
Expires 12/15/09

My commission expires _____

TNI AD NO. _____

4423817

PUBLIC NOTICE OF AN
APPLICATION FOR AN ORDER
AUTHORIZING ARIZONA
WATER COMPANY TO SELL
BONDS

Arizona Water Company ("Applicant") has filed an Application with the Arizona Corporation Commission (the "Commission") for an order authorizing Applicant to issue and sell one or more additional series of its General Mortgage Bonds in an aggregate principal amount not to exceed \$25,000,000. The Applicant also seeks authorization to determine the precise amount and timing of the issuance and sale of each additional series of General Mortgage Bonds. The Applicant expects to issue the first series of bonds on or before July 31, 2006 at a negotiated rate of no more than 200 basis points over the 30-year Treasury Rate. The Application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, and at Applicant's offices throughout Arizona.

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Publish January 10, 2006
The Arizona Daily Star
Tucson Citizen